No. 15755

United States
COURT OF APPEALS
for the Ninth Circuit

MERRIMAN H. HOLTZ and HELENE TYROLL HOLTZ,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S BRIEF

Petition to Review a Decision of the Tax Court of the United States

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STATEMENT OF JURISDICTION

The petition for review of the decision of the Tax Court of the United States in Docket No. 58 455 by the United States Court of Appeals for the Ninth Circuit was filed pursuant to 26 U.S.C. Sec. 7482 and 7483 (Tr. 34).

The petition for redetermination of the proposed deficiency was filed in the Tax Court of the United States pursuant to 26 U.S.C. Sec. 7442 (Tr. 5).

STATEMENT OF THE CASE

The petitioners are husband and wife, and have resided in Portland, Oregon, since 1930, except during the years 1943 to 1945 when petitioner, Merriman H. Holtz, temporarily resided in Washington, D. C., during which period he fulfilled duties under a special appointment in connection with the promotion and sale of War Bonds for the Treasury Department (Tr. 18).

This petition for review is primarily concerned with the business activities of petitioner, Merriman H. Holtz and hereinafter the designation "petitioner" has reference to him.

During the period 1930-1950 petitioner organized, financed and managed four corporations and a single proprietorship business; the principal activity of these enterprises was the distribution, sale and rental of motion picture equipment, accessories and film. Petitioner was actively engaged in the management and operation of all of these enterprises (Tr. 19, 21, 22, 23).

Petitioner's financing activities in connection with the corporations were consistent and numerous and in the form of personal guarantees to The United States National Bank of Portland, Oregon, on loans which that bank made to the several corporations. During the ten year period from 1941-50 inclusive, for example, petitoner guaranteed borrowings of the corporations in over 250 instances and in individual amounts ranging up to $140,000.00 (Exs. 5E, 6F, 7G, 8H, 9I, 10J).

In October 1949, Screen Adette Equipment Corporation, one of the corporations which petitioner had organized, financed and operated filed a voluntary petition in bankruptcy in the United States District Court for the District of Oregon. In January and March, 1950, the United States National Bank of Portland, Oregon, sold collateral securities which had been personally pledged by petitioner, the market value of which when pledged, exceeded by a considerable amount the indebtedness of the corporation guaranteed by the petitioner. The Bank realized $83,316.29 from the sale and applied that amount upon the debt of the corporation, leaving a balance still owing by petitioner of $64,119.34 (Tr. 20).

The petitioners filed a joint income tax return for 1950 and claimed the payment made by them to the United States National Bank of Portland as a business bad debt deductible under the provisions of Section 23(k) (1) of the Internal Revenue Code of 1939. Their tax return for the year 1950 showed a net operating loss of $76,656.23. By virtue of a carry-back of a portion of said net operating loss, petitioners claimed and obtained a refund of their 1949 income taxes in the amount of $958.30 (Tr. 12, 13, 14, 15, 18, Exs. 1A, 2B).

Respondents asserts that the bad debt loss incurred in 1950 was a non-business bad debt, deductible under the provisions of Section 23(k) (4) of the Internal Revenue Code of 1939 (Tr. 18, 19). Section 23(k) (4) provides that a non-business bad debt is to be treated in the same manner as a short term capital loss, i.e., deductibility is limited to the amount of capital gains

during the period in question plus $1000.00 which may be offset against ordinary income.

Accordingly, respondent contends that petitioners owe taxes for the year 1950 in the amount of $671.66, after making allowance for the $1000.00 capital loss deduction permitted under Section 23(k)(4), and that the refund obtained for 1949 in the amount of $958.30 was improperly claimed and collected (Tr. 12, 13, 14, 15).

Petitioners contend that the loss incurred during 1950 was proximately related to the trade or business of petitioner Merriman H. Holtz, which was the sale, rental and distribution of motion picture equipment, supplies and film, and the organizing, financing and managing of business enterprises engaged in such sale, rental and distribution, and which business was conducted by him during and throughout the period 1930 to 1950 inclusive; and that accordingly petitioners correctly treated said loss as a fully deductible business bad debt under Section 23 (k)(1) (Tr. 6).

In the Tax Court all facts were stipulated by the parties hereto and respondent's contention was sustained (Tr. 26, 34).

SPECIFICATION OF ERRORS

Petitioner relies upon the specification of errors contained in a statement of points on appeal heretofore filed in the within cause, and generally that the findings of fact and conclusions of law made by the Tax Court are erroneous, as follows:

1. The Tax Court erred in holding that any deficiency exists with respect to petitioners' income tax liability for the calendar years 1949 and 1950.

2. The Tax Court erred in holding that the activities of petitioner Merriman H. Holtz during the period 1930-1950 inclusive, did not constitute the business of organizing, financing and managing businesses.

3. The Tax Court erred in holding that the activities of petitioner Merriman H. Holtz during the period 1930-1950 were not sufficiently extensive to establish the existence of the business of organizing, financing and managing businesses.

4. The Tax Court erred in holding that the indebtedness in question did not bear a proximate relationship to petitioner's trade or business either at the time the loan was made or at the time it became worthless.

5. The Tax Court erred in sustaining the Commissioner's disallowance of the business bad debt petitioners had deducted upon their 1950 income tax return under the provisions of Section 23(k)(1) of the Internal Revenue Code of 1939 in the sum of $83,316.29, being payment made to the United States National Bank of Portland as guarantors on notes to one of the corporations which petitioners had organized, operated, financed and managed, and conversely the Tax Court erred in holding such payment by petitioners was a non-business bad debt deductible only as provided by Section 23 (k)(4), Internal Revenue Code of 1939.

6. The Tax Court erred in that its opinion and decision are not supported by the facts and are contrary to law.

SUMMARY OF ARGUMENT

The Revenue Act of 1942 added Section 23(k)(4) to the Internal Revenue Act of 1939. This section limited the deductibility of non-business bad debts by treating such bad debt losses as short-term capital losses. The intent of the Congress, in adding this restriction, was primarily to restrict the deductibility of bad debts when the loans out of which they arose had been made to relatives or friends; there is no indication whatsoever of a legislative intent to treat as non-business debts loans of the type involved in the case under consideration.

The Tax Court, in construing Section 23(k)(4) with respect to the deductibility of bad debts, has determined that a taxpayer engaged in doing business through the medium of controlled corporations does not qualify for business bad debt treatment with respect to a loan made to one of his controlled corporations, unless his activities are of such nature that it can be said that he is in a separate business of organizing, financing and managing corporations. It is the contention of petitioner that this determination of the Tax Court goes far beyond the intent of Congress when it enacted Section 23(k)(4), and that a taxpayer engaged in business activity which he conducts through controlled corporations suffers a business bad debt loss when a loan made to one of his corporations, with full expectation of repayment, subsequently becomes worthless.

In the alternative petitioner contends that his activities were sufficiently extensive in the business of organ-

izing, financing and managing corporations, and that, accordingly, the bad debt loss suffered by him during the year 1950 should be treated as a business bad debt and not as a non-business bad debt.

The question to be determined here basically is one of statutory interpretation, namely, whether or not the activities of petitioner Merriman H. Holtz, during the period 1930-1950 inclusive, were business or non-business activities, within the intendment of Congress, when it added Section 23(k)(4) to the Internal Revenue Code of 1939.

ARGUMENT

I

CONGRESS, IN ENACTING SECTION 23(k)(4) OF THE INTERNAL REVENUE CODE OF 1939, DID NOT CONTEMPLATE THE CLASSIFICATION OF A LOSS OF THE TYPE UNDER CONSIDERATION HEREIN AS A NON-BUSINESS BAD DEBT.

Prior to the effective date of the Revenue Act of 1942, there was no distinction in the tax treatment of bad debts, whether business or non-business. All bad debt losses were fully deductible from ordinary income under Section 23(k)(1) of the Internal Revenue Code of 1939. Section 124(a) and 124(d) of the Revenue Act of 1942 amended Section 23(k)(1), making it applicable only to business bad debts, and added Section 23(k)(4) which provided that losses from non-business bad debts were to be treated as short term capital losses with limited deductibility against ordinary income. No adequate defi-

nition of "business" or of "non-business" was provided in the Act.[1]

The primary rule to be applied in the construction of statutes is to ascertain and declare the intention of the legislative body. U. S. v. Cooper Corp., 312 U.S. 600, 61 S. Ct. 742, 85 L. Ed. 1071, U. S. v. N. E. Rosenblum Truck Lines, 315 U.S. 50, 62 S. Ct. 445, 86 L. Ed. 671.

The House Ways and Means Committee Report, discussing the situation which was intended to be rectified by the addition of Section 23(k)(4) to the Revenue Act of 1939, contains the following language (emphasis supplied):

> "The present law gives the same tax treatment to bad debts incurred in non business transactions as it allows to business bad debts. *An example of a non business bad debt would be an unrepaid loan to a friend or relative, while business bad debts arise in the course of the taxpayer's trade or business.* This liberal allowance for non business bad debts has suffered considerable abuse through taxpayers making loans which they do not expect to be repaid. *This practice is particularly prevalent in the case of loans to persons with respect to whom the taxpayer is not entitled to a credit for dependents* * * * HR Rep. No. 2333, 77th Congress, 2d Sess. 45.

The legislative purpose would appear unmistakably to be concerned with abuse of the bad debt deduction through loans to friends or relatives where no business purpose was manifested or where there was no expectation of repayment, particularly where a "loan" was made

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[1] Section 23(k)(1) and 23(k)(4) are set forth in the Appendix.

which in effect gave the taxpayer a dependency credit to which he was not otherwise entitled. It is submitted that only an extremely strained construction of the above quoted segment of the Committee Report could lead to the conclusion that it was intended by Congress to deny a business bad debt deduction to a taxpayer who suffers severe losses from a personal guarantee made on behalf of a controlled corporation, where the financing of the corporation, and of several other corporations controlled by the taxpayer, is part of a regular and extensive pattern carried on for many years, and particularly where the organization, financing and management of the corporations constituted the principal business activity of the taxpayer for a period of twenty years.

The Tax Court in *Cluett v. Commissioner,* 8 TC 1178, 1179 confirmed this interpretation of the legislative intent with respect to Section 23(k)(4):

> "The legislative history of Section 23(k)(4) indicates that its principal purpose was to place a limitation upon losses from bad debts, such as loans to relatives or friends which had no connection with the business of the lender."

Subsequent to the enactment of Section 23(k)(4), numerous cases have been considered by the Tax Court wherein the primary question to be decided was whether or not a taxpayer's activities were such that a loss suffered by him in connection with a loan to a controlled corporation could be deemed a business bad debt loss. The Tax Court, in considering this question, has determined in many cases that the taxpayer who suffers a bad debt loss on a loan to a corporation controlled by

him is not entitled to a business bad debt deduction, unless he is in a *separate* business of organizing, financing and managing corporations, or is engaged in the business of lending money.

D. J. Salomone, 27 TC 663;
W. M. Mayo, TC Memo 1957-9;
A. F. Lasker, TC Memo 1956-242;
Henry E. Sage, 15 TC 299.

Thus in its memorandum opinion in the case at bar, the Tax Court said that the activities of petitioner disclosed that he "devoted himself to carrying on a business enterprise by means of wholly-owned corporations," but the activities were held to be not sufficiently extensive to establish the existence of a "separate" business of promoting, organizing, financing and managing businesses during 1950 (Tr. 33, 34).

In effect, the Tax Court held that a taxpayer engaged in carrying on a business enterprise by means of wholly owned corporations, and who suffers a bad debt loss in connection with a loan to one of his corporations, has not incurred a business bad debt loss, but has instead incurred a non-business bad debt loss. In looking at the evil which Congress sought to cure by the enactment of Section 23(k)(4), as very clearly expressed in the House Ways and Means Committee Report, supra, it would seem to be obvious that there was no intent to exclude from the concept of "trade or business," the activities of a taxpayer engaged in carrying on a business enterprise through controlled corporations. To do so would in effect be to say that such a taxpayer has no trade whatsoever.

It is interesting to note that the respondent has never

made a contention that the businesses of the petitioner were undercapitalized or thin corporations, so that the loans made or guaranteed by petitioner might be deemed capital contributions.

It is and has been for many years, a common practice for individuals to form closely held corporations, and to carry on their trade or business activities by means of such corporations. Had it been the intent of Congress that Section 23(k)(4) was to have application to bad debt losses suffered on loans to closely held corporations, it is submitted that a reference to this very common situation would have been made by the Committee in its Report. Instead, the reference in the Committee Report to a non-business bad debt is "an unrepaid loan to a friend or relative." In addition the Committee indicated clearly that the abuse which it sought to cure was the practice of taxpayers in "making loans which they do not expect to be repaid." In the instant matter the facts clearly disclose that the petitioner did not make a loan which he did not expect to be repaid.

In order to bring the transaction involved herein within the clear intent of Congress, it is necessary to find an analogy between a "friend or relative," and a corporation controlled by the taxpayer. This obviously requires a distorted view of the Committee's intent in enacting the legislation in question. Even if this construction should be adopted, it is, nevertheless, apparent that the petitioner's loans or guarantees were not of the type under consideration by the Committee, for clearly there was always the expectation of repayment at the time the guarantees were made.

II

THIS COURT (IN MALONEY v. SPENCER, 172 F2d 638) AND OTHER COURTS HAVE HELD THAT A WORTHLESS DEBT LOSS INCURRED UNDER CIRCUMSTANCES ANALOGOUS TO THOSE PRESENT HEREIN SHOULD BE TREATED AS A BUSINESS BAD DEBT LOSS, FULLY DEDUCTIBLE UNDER THE PROVISIONS OF SECTION 23(k)(1) OF THE INTERNAL REVENUE CODE OF 1939.

Maloney v. Spencer (9th Cir.), (1949) 172 F. 2d 638, involved bad debt losses suffered by the taxpayer during the year 1945. In 1943, the taxpayer organized three corporations and became the sole stockholder in all three, except for qualifying shares. He was the owner individually of three food packing plants and he leased these plants, one to each corporation; he also entered into an agreement with his corporations to provide financing for them. Upon the failure of two of the corporations, the taxpayer was required to pay, as surety for corporate debts, amounts totalling $95,081.48, which payments he treated as business bad debts. The Collector of Internal Revenue denied the business bad debt deduction, but the District Court, 7 Fed. Supp. 657, 658, found that taxpayer "was engaged in the business of acquiring, owning, expanding, equipping, and leasing food processing plants," and upheld the deduction as a business bad debt. This Court denied the Collector's contention, on appeal, that the District Court's finding was "clearly erroneous" and affirmed the judgment.

Had Spencer conveyed the properties to the corporations and accepted stock therefor, instead of leasing to the corporations, he would, under the Tax Court's

holding in the case at bar, have been denied a business bad debt deduction. It is submitted that a different tax effect should not result from the mere device of retaining in individual ownership business properties which are then leased to wholly owned corporations. Thus, if Holtz had sublet the business properties which were used by his corporations and, then being in the position of lessor, had suffered the actual losses which occurred, it would appear that an entirely different result would have obtained.

In *Maloney v. Spencer,* the situation basically was exactly the same as in the case at bar. In each case, the taxpayer devoted his business life to a single line of business which he conducted through the medium of wholly owned corporations. The sole difference between the two cases is that in the *Spencer* case, the taxpayer owned the properties which his corporations were using as their plants and that he, instead of conveying them to the corporations, retained the ownership thereof.

In *Spencer,* the taxpayer furnished the physical plants to his wholly owned corporations. In the case under consideration, petitioner Merriman H. Holtz furnished personal credit and personally owned securities to aid the operation of his corporations.

In the instant case, as in *Spencer,* the taxpayer's activities were extensive, varied, continuous and regular. His financing activities clearly cannot be said to be "isolated or occasional transactions" as was the case in *Burnet v. Clark,* 287 U.S. 410, and in *Dalton v. Bowers,* 287 U.S. 404, for the record is replete with evidence of

the extensive and continuing nature of his loans and guarantees. (Exs. 5E, 6F, 7G, 8H, 9I, 10J.) That his management activities were continuous and regular is also undisputed (Tr. 19, 21, 22, 23). In the *Spencer* case the taxpayer had organized, financed and operated three corporations, and in the instant case, the taxpayer organized or acquired, and financed and operated four corporations (Tr. 19, 21, 22, 23).

It is the contention of petitioner herein that the requirement that a taxpayer who makes loans to controlled corporations which he actively operates must be in a *separate* business of organizing, financing and operating corporations, in order to be permitted a business bad debt deduction for such loans which become worthless, is not in conformity with the clearly expressed Congressional intent. However, even should such a test be applied, it is submitted that petitioner's activities during and throughout the period in question were such that he clearly can be said to have been engaged in the business of organizing, financing and managing corporations, as that business has been defined by the courts.

During the years 1930-1950 inclusive, petitioner owned or organized and financed four separate corporations, and was actively engaged in the management of all of these enterprises (Tr. 19, 21, 22, 23). His financing activities were numerous and consistent; he guaranteed loans made to the corporations in amounts ranging up to $140,000.00, and in over 250 different instances during the period 1941-1950 alone. (Exs. 5E, 6F, 7G, 8H, 9I, 10J).

In *Giblin v. Commissioner* (5th Cir.), 227 F.2d 692, the taxpayer was an attorney who, during the period from 1926 to 1945, while engaged in the practice of law, contributed time, energy and money to a number of business enterprises *entirely unconnected with his law practice.* On the strength of evidence which showed that about 50% of the taxpayer's time was devoted to the various enterprises in which he engaged, the Court of Appeals for the Fifth Circuit in reversing the Tax Court stated, at p. 698, that,

> "To hold that a loss suffered from the becoming worthless of a loan made to one of these enterprises was not suffered in the course of his engaging in a trade or business, would be to apply a sterile and rigid approach that is not contemplated by the statute."

and at p. 696, that,

> "both the Tax Court and Court of Appeals have recognized the type of activity engaged in by petitioner as satisfying the requirements of 'carrying on any trade or business,' when such activity has been sufficiently extensive to warrant the conclusion that the individual involved is more than a passive investor. Foss v. Commissioner of Internal Revenue, 1 Cir. 75 F2d 326; Maloney v. Spencer, 9 Cir. 172 F2d 638; Commissioner of Internal Revenue v. Stokes' Estate, 3 Cir. 200 F2d 637."

There can be no question but that the petitioner, Merriman H. Holtz, was far more than a "passive investor." His entire business life during the twenty year period involved in the matter at bar, was devoted to the furtherance of his business of organizing, financing, managing and operating corporations primarily engaged in selling, renting and distributing motion picture equip-

met, film and supplies. Can it be said that Giblin, who participated in eleven or twelve different enterprises over a twenty year period while primarily engaged in the practice of law was in a "business" other than his law practice, but that petitioner, Merriman H. Holtz, who devoted practically all of his time during a similar period of years to organizing, financing and managing his corporations was not engaged in a business? It is submitted that to do so would, as the United States Court of Appeals for the Fifth Circuit said in *Giblin,* require the application of a "sterile and rigid approach that is not contemplated by the statute."

In *Commissioner v. Stokes' Estate,* 200 F.2d 637, the decedent taxpayer had been engaged in locating, developing and exploiting patents by organizing, financing and actively participating in the management of corporations which had been organized to acquire such patents or operate under them, or by transferring such patents to existing companies in which he was a stockholder and active in management. The United States Court of Appeals for the Third Circuit held, at p. 638, that the

> "* * * evidence established that (the taxpayer's) activities in locating, developing and exploiting patents involved much more than the mere investment of funds in and management of corporations. It was quite clearly a personal activity in which a major portion of the decedent's lifetime thought and energy was enlisted and in which he engaged continuously and regularly throughout his business career. In these respects this case—resembles Maloney v. Spencer, 9 Cir. 1949, 172 F2d 638, 640; Vincent C. Campbell v. Commissioner, 1948, 11 TC 510 acq. 1949-1 CB1. * * *"

The Court upheld the contention of the taxpayer's estate that a debt owed to Stokes by one of the companies which he had employed in connection with his activities was properly deductible as a business bad debt.

As in *Stokes,* taxpayer in the case at bar had been engaged primarily in a single field of endeavor and he conducted his activities in that field through corporations organized for that purpose. Here, too, it can be said that a major portion of taxpayer's lifetime, thought and energy have been enlisted in the pursuance of these activities.

In addition to the organizing, financing and management of his various business enterprises, the "personal activity" aspect is further emphasized by the prominent part played by petitioner, Merriman H. Holtz, in trade association activities, as one of the organizers of and as a director and officer in the National Association of Visual Education Dealers for a period of eleven years (Tr. 24).

In *Vincent C. Campbell et al v. Commissioner,* 11 TC 510, the taxpayers were engaged in the retail coal business. During the period 1929 through 1944, they organized, owned and operated twelve corporations engaged in selling coal at retail. Loans were made to these corporations and petitioners suffered a bad debt loss in connection with one of the companies. The Tax Court, in its opinion by Murdock, J., held that the bad debt loss was,

> "directly a result of, and incurred in, the business of organizing and operating corporations engaged

> in the retail coal business, which business of organizing and operating such corporations was carried on by the petitioners during the taxable year."

The Tax Court, in its opinion in the case at bar (Tr. 31, 32) apparently distinguishes the *Campbell* case from the instant case by a statement to the effect that in *Campbell* it was shown that from 1929 through 1944 the taxpayer had organized, managed and financed twelve corporations. The Tax Court, in its opinion below, cites the *Campbell* case as authority for the holding that, in order for for a worthless debt resulting from a loss by a stockholder to his corporation to qualify as a business bad debt the stockholder must be active in a "variety of businesses."

It is clear that in *Campbell,* the corporations were engaged in but a single business—that of selling coal at retail. The distinction which the Tax Court sought to draw between *Campbell* and the instant case was, therefore, meaningless, for petitioner herein was engaged in a considerably greater variety of businesses than were the taxpayers in *Campbell;* he was active during the period in question in organizing, financing and managing busiesses engaged in the sale of motion picture equipment (Screen Adette Equipment Corporation) motion picture film and equipment. (Screen Adettes, Inc.) motion picture film (Pictures, Inc.) and ladies' apparel (Helene's, Inc.) (Tr. 19, 21, 22, 23.)

If the distinction between the instant case and *Campbell* is sought to be drawn on the basis of the *number* of corporations involved, it would appear that

such a distinction rests on an unsound foundation. Logically, there would appear to be required a consideration of the extent of the taxpayer's total activities which fall within the scope of the business of organizing, financing and managing business enterprises. Thus, if he had organized numerous corporations, had made but a single loan, and had not participated in management activities, it could not be said under the Tax Court's determination, that he was engaged in the business of "organizing, financing and managing" corporations. By the same token, if the taxpayer organizes but a single corporation, he could not logically claim to be in the business of "organizing, financing and managing" business enterprises, regardless of the extent of his financing and management activities with respect thereto. However, where the taxpayer, as in the instant case, has organized or acquired several corporations, and where his financing activities with respect thereto are consistent and numerous and where his entire business life for a period of twenty years is devoted to the management, financing and operation of the corporation, it is submitted that such a case falls within the rationale of *Campbell,* and within a reasonable contemplation of the intent of Congress with respect to what was to constitute "business" activity within the meaning of Section 23(k)(4).

Petitioner Merriman H. Holtz could easily have organized additional corporations, for he had offices in several states and could logically have done so, and under the reasoning of the Tax Court, if petitioner Holtz had carried on the same business activities through the

medium of additional corporate entities he would be engaged in a "business" as were the taxpayers in *Campbell;* having failed to do so, his activities are said to be of a non-business nature.

The total number of lending transactions involved in the *Campbell* case is not indicated; in the case at bar there were in excess of 250 loan transactions during the ten-year period 1941-1950 (Exhibits 5E, 6F, 7G, 8H, 9I, 10J).

In *Tony Martin v. Commissioner,* 25 TC 94, the taxpayer was a singer and entertainer who had suffered some adverse publicity while serving in the Armed Forces during World War II. Upon his honorable discharge from the service he was unable to obtain employment as a result of the aforesaid publicity. In order for him to achieve public acceptance again, Martin and his advisers decided that he had to make a good motion picture. Accordingly, Martin and others formed a corporation to produce the picture. The corporation was unable to borrow sufficient funds to complete the picture and Martin himself advanced money to the corporation for that purpose. The picture reestablished Martin but the corporation went into bankruptcy, and Martin suffered a bad debt loss. The Tax Court ruled that the bad debt loss incurred by Martin qualified as a business bad debt because it had the necessary proximate relation to Martin's business as an entertainer.

It is submitted that the taxpayer in the instant matter should be entitled to a business bad debt deduction within the meaning of Section 23(k)(1) more readily

than the taxpayer in the aforementioned Tax Court decision, for during twenty years he was engaged in the business of renting, selling and distributing motion picture film and equipment, and organizing, financing and operating corporations to carry out such business and certainly the bad debt loss suffered by him bore a proximate relation to his "trade or business."

CONCLUSION

The Tax Court has clearly erred in its determination and is relying on a narrow and unwarranted application of the Congressional intent in enacting Section 23(k)(4) of the Internal Revenue Code of 1939; as the Court of Appeals for the Fifth Circuit said in *Giblin v. Commissioner,* 227 F.2d 692, the Tax court has applied "a sterile and rigid approach that is not contemplated by the statute."

This court, in *Maloney v. Spencer,* 172 F.2d 638, sustained the taxpayer's contention that he was entitled to a business bad debt deduction under the provisions of Section 23(k)(1) of the Internal Revenue Code of 1939. The facts in the instant matter are strikingly similar to those in the *Spencer* case, and unmistakably meet the standards prescribed by the other cited decisions of the United States Courts of Appeal for engaging in a "trade or business." Petitioner should therefore be permitted to deduct as a business bad debt the loss sustained on account of the payment in 1950 of guarantees of bank loans to one of his several wholly owned cor-

porations engaged in carrying on his trade of leasing, selling and distributing motion picture film equipment and supplies.

Respectfully submitted,

Moe M. Tonkon,
Attorney for Petitioner.

APPENDIX

INTERNAL REVENUE CODE, 1939

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(k) Bad Debts.—

(1) General rule.—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. *This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection . . .*

(4) Non-business debts.—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. *The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.*

(Pertinent portions of Act have been italicized.)

EXHIBITS RECEIVED IN EVIDENCE BY STIPULATION